



**STATE INVESTMENT BOARD  
BOARD ADOPTED POLICIES**

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**POLICY NUMBER:** 2.25.100

**EFFECTIVE DATE:** 3/21/02

**TITLE:** Permanent Funds' Portfolios

**SUPERSEDES:** 9/16/99

**BOARD ADOPTION:** 3/21/02

**APPROVED:**

A handwritten signature in black ink, appearing to read "James Brueckner", is written over the word "APPROVED".

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**PURPOSE:**

This document outlines the State Investment Board's (SIB) investment policy and guidelines for the permanent funds and supersedes any prior Board-adopted policies.

These guidelines allow for sufficient flexibility in the management process to capture investment opportunities, while providing parameters that ensure prudence and care in the execution of the investment program for permanent funds.

The following permanent funds are invested by the SIB:

- Agriculture Permanent Account
- Millersylvania Park Trust Account
- Normal School Permanent Account
- Permanent Common School Account
- Scientific Permanent Account
- State University Permanent Account

A full description of each fund, including the specific asset allocation and performance benchmark, is listed in Addendum A.

**POLICY:**

**Standard of Care**

Under RCW 43.33A.030, trusteeship of the state's permanent funds is vested in the voting members of the Board. The Legislature has established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the Board and its staff must comply with other state laws, such as the Ethics in Public Service Act, Chapter 42.52 RCW, as it makes its investment decisions and seeks to meet the investment objectives listed below.

### **Strategic Objective**

The strategic objectives for the permanent funds' portfolios are:

The permanent funds' investments are to be managed to achieve the highest return possible consistent with the desire to emphasize high current yield to maturity opportunities and to add value through active management. The strategic objectives include:

1. Safety of principal
2. Current income
3. Long-term stability of purchasing power
4. Preservation of the public's trust

Taken together, these objectives imply portfolios for which growth keeps pace with inflation over time (preservation of capital), and that are able to provide a stable level of income sufficient to meet each fund's constituent needs.

### **Performance Objective**

In most cases, the permanent funds' investments are to emphasize stability and maximize income to support the operations of each irreducible trust. The Permanent Common School Fund does have a small equity allocation which incorporates limited exposure to portfolio growth.

Within the required accounting guidelines, the permanent funds' portfolios are to be managed, so that their individual performance meets or exceeds the return of each fund's specific benchmark with a volatility of returns that, over time, is similar to or less than the benchmark's for a similar level of returns.

For the funds holding portfolios consisting of only fixed income, the performance benchmark is the Lehman Aggregate Index.

For funds holding both equity and fixed income, the performance benchmark shall be a combination of an equity index representative of the equity held in the fund and the Lehman Aggregate Index, in percentage allocations that represent the fund's target allocations.

The Board will measure both the book value income return and the marked-to-market total rate of return on the funds.

### **Risk Tolerance**

Risk will be managed in a prudent manner. Since the stakeholder only receives the current income and net capital appreciation of the assets, the funds have a below average ability to tolerate volatility in current income.

### **Portfolio Constraints**

- A. All assets under management by the SIB are to be invested to maximize return at a prudent level of risk in accordance with the requirements of statutes RCW 43.33A.110 and RCW 43.33A.140, which state, in part, that the SIB is to "...establish investment policies and procedures designed to attempt to limit fluctuations in industrial insurance premiums, and, subject to this purpose, to maximize return at a prudent level of risk."
- B. No corporate fixed income issue's cost shall exceed three percent of the fund's market value at the time of purchase, nor shall its market value exceed six percent of fund's market value at any time (RCW 43.33A.140).

### **Permissible Investments**

- A. Any SIB managed fund that meets a fund's investment objectives and its permissible investments constraints.
- B. U.S. and non-U.S. public equity (only the Permanent Common School Fund has been constitutionally approved to hold equity, as of the date of this policy).
- C. Investment Grade Fixed Income:

*Investment Grade* is defined as rated Baa3 or higher by Moody's Investors Service.

Although fixed income securities that are rated below investment grade may not be purchased, portfolio holdings that are downgraded to those levels or are no longer rated may continue to be held.

Permissible Fixed Income Market Segments:

- 1. *U.S. Treasuries and Government Agencies.*
- 2. *Credit Bonds.*
- 3. *Mortgage Backed Securities.*
- 4. *Asset Backed Securities.*
- 5. *Commercial Backed Mortgage Securities.*
- 6. *Convertible Securities.*

7. *Eurodollar Bonds.*
8. *Non-Dollar Bonds.*

Other fixed income segments and instruments may be added from time to time as they are developed or deemed appropriate.

### **Sector Allocations**

Portfolio allocations are to be managed within the ranges presented below. These targets are long-term in nature. Deviations may occur in the short-term as a result of interim market conditions; however, if a range is exceeded, the portfolio must be rebalanced to the target allocations, as soon as it is practical.

(The target allocations below are applicable to all irreducible trusts except Millersylvania Park Trust. The small size of this Trust's corpus precludes practical implementation.)

Target allocations for the Fixed Income Sectors:

|   | <u>Range</u> |
|---|--------------|
| U.S. Treasuries and Government Agencies | 10 – 50%     |
| Credit Bonds                            | 10 – 50%     |
| Asset Backed Securities                 | 0 – 10%      |
| Commercial Mortgage Backed Securities   | 0 – 10%      |
| Mortgage Backed Securities              | 5 – 40%      |
| <b>Total Bonds</b>                      | <b>100%</b>  |

Duration Target: The fixed income portfolio's duration is to be targeted within plus or minus 20 percent of the duration of the portfolio's performance benchmark, the Lehman Aggregate Index.

### **Reporting**

- A. A management information system is to be used for reporting internally to senior staff on the implementation of this policy. This report is prepared monthly to include, but is not limited to:
  1. Current market values and allocations, by sector, compared to the index and the policy ranges;
  2. Aggregate and individual portfolio characteristics compared to guidelines; and,

3. Delinquencies and defaults.
- B. An executive management report is to be provided to the Board quarterly showing market values and performance.
  - C. At minimum, annual reports on the asset allocation, income return, and trust status will be provided to stakeholders.

#### **RESPONSIBILITIES:**

State Investment Board - Responsible for approving the funds' strategic investment policy

Administrative Committee - Responsible for reviewing and recommending investment policy and asset allocation to the Board and for reviewing staff investment management guidelines.

Public Markets Committee - Responsible for reviewing and recommending the strategic policy to the Board, and for reviewing the structure, strategy, and performance of the funds.

Staff - Responsible for recommending an investment policy to the Public Markets Committee, for implementing the policy, and for reporting to the Public Markets Committees and to the Board.

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Policy Adopted 11/18/93

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